

Internal Revenue Service**Department of the Treasury**

Number: **200242009**
Release Date: 10/18/2002
Index No.: 1031.00-00

Washington, DC 20224

Person to Contact:**Telephone Number:**

(202) 622-4950

Refer Reply To:

CC:ITA:3 – PLR-116604-99

Date:

July 3, 2002

LEGEND:

Parent	=
Taxpayer	=
QI	=

Dear :

This letter responds to your request for a private letter ruling submitted on behalf of Taxpayer, requesting rulings on issues concerning its establishment of a like-kind exchange program under section 1031 of the Internal Revenue Code.

FACTS

Taxpayer is a wholly-owned subsidiary of a subsidiary which, in turn, is owned by Parent, a multi-state bank holding company.

Taxpayer is primarily engaged in the business of leasing vehicles to consumers and issuing loans to consumers for the purchase of vehicles. Taxpayer currently maintains a portfolio of vehicles leased to individual customers for non-commercial use. These vehicles are automobiles, passenger vans, light duty trucks, and sport utility vehicles ("SUVs"). Typically the leases range from twelve months to sixty-three months in duration. Taxpayer has legal title to each vehicle and depreciates each vehicle pursuant to section 168.

Taxpayer restructured its vehicle leasing operations with the intention that the disposition of a vehicle coming off lease (a relinquished vehicle) by Taxpayer to an unrelated party and the acquisition by Taxpayer of a vehicle recently leased from a dealer (a replacement vehicle) will qualify as a like-kind exchange under section 1031. Relinquished vehicles are typically sold to the dealer, the lessee, or a third party through an auction. Replacement vehicles are usually purchased from an unrelated dealer.

PLR-116604-99

To meet the requirements of section 1031, Taxpayer entered into an agreement with QI (the Exchange Agreement), under which QI is to act as the qualified intermediary under section 1.1031(k)-1(g)(4) of the Income Tax Regulations. Accordingly, Taxpayer assigns its rights for the sale of relinquished vehicles and the purchase of replacement vehicles to QI.

QI is a corporation wholly owned by a third party that is unrelated to Taxpayer. QI has not previously performed services other than routine financial services for Taxpayer.

Under the Exchange Agreement, QI is to keep an escrow account and a disbursement account at a financial institution unrelated to Parent or Taxpayer. The escrow account is to hold the proceeds from relinquished vehicles, while the disbursement account, consisting of funds solely from the escrow account, is to pay for replacement vehicles. If the disbursement account does not contain a sufficient amount of funds to acquire replacement vehicles, Taxpayer will supply additional funds to the disbursement account to cover any deficiency.

The Exchange Agreement expressly limits Taxpayer's rights to receive, pledge, borrow or otherwise obtain the benefits of money or other property held by QI before the end of the exchange period. For this purpose, the exchange period begins on the day of the sale of the relinquished vehicle and ends at midnight on the 45th day following the sale of a relinquished vehicle if no replacement vehicle is identified. If a replacement vehicle has been identified during the 45-day window, the exchange period will end the earlier of the 180th day following the sale of the relinquished vehicle or the date Taxpayer receives the replacement vehicle. The Exchange Agreement provides that Taxpayer has a right to receive money or other property held by QI prior to the end of the exchange period only upon the occurrence of an event described in section 1.1031(k)-1(g)(6)(ii) or (iii).

The Exchange Agreement authorizes QI to purchase all leased vehicles on Taxpayer's behalf, including vehicles that will not be replacement vehicles for purposes of a like-kind exchange. Periodically, Taxpayer will assign QI the right to sell all vehicles purchased by Taxpayer after the date of the Exchange Agreement. Non-replacement vehicles are purchased by QI and paid for out of the disbursement account in the same procedures applicable to replacement vehicle purchases. This is done because Taxpayer currently acquires more vehicles than are being relinquished and it matches each replacement vehicle with one relinquished vehicle for basis tracking purposes. The unmatched vehicles are non-replacement vehicles.

Sale of Relinquished Vehicles

The exchange transactions take place on completion of a lease term, or upon early termination of a lease. At such time, the vehicle will be offered to sale to the lessee, and if the lessee refuses, then to the dealer. The transactions are then carried out as follows.

In a typical transaction, the lessee of a vehicle decides to purchase the vehicle from Taxpayer. Consequently, the lessee contacts Taxpayer's customer service department to obtain the purchase price of the vehicle. During the time of the phone call, a customer service representative verbally notifies the lessee that Taxpayer's rights to sell the vehicle have been assigned to QI. Additionally, this notification appears in the lessee's payment coupon booklet.

After receiving an offer from the lessee to purchase the vehicle, Taxpayer includes the vehicle's purchase price, lease numbers, and purchaser's name on a list that is then sent to QI. The list contains notification that the vehicles are being assigned from Taxpayer to QI.

The lessee will forward to Taxpayer a check made payable to QI. Taxpayer will receive the check in order to process the paperwork associated with the lease transaction. Since Taxpayer maintains the leases on its accounting system, Taxpayer will have all information necessary to ascertain whether the paperwork and check amounts are in order. Due to the volume of outstanding leases, these are significant tasks.

In some cases, the lessee purchases the vehicle using funds borrowed from one of the banking subsidiaries of Parent. This loan occurs in a separate arm's-length transaction. After the loan agreement is executed, the banking subsidiary mails a check to Taxpayer. The check is made payable to the order of QI. Pursuant to the Exchange Agreement, Taxpayer forwards the check to QI for deposit into the escrow account. After QI has received the check, Taxpayer arranges to transfer title of the vehicle to the lessee.

Additionally, in some cases, the lessee elects to have the lease security deposit held by Taxpayer applied to the purchase of the vehicle. In those circumstances, Taxpayer will ask the lessee to request in writing that Taxpayer, as the lessee's agent, forward the security deposit to QI in satisfaction of part of the purchase price. Taxpayer will make a check payable to QI for the amount of the security deposit and forward it along with the lessee's purchase check to QI.

Acquisition of Replacement Vehicles

Taxpayer acquires replacement vehicles pursuant to contracts Taxpayer has entered into with unrelated dealerships, in which Taxpayer agrees to purchase from the dealer each vehicle leased by the dealer under certain terms and conditions. Before the purchase transaction, Taxpayer sends each dealer a letter notifying the dealer that Taxpayer's rights to purchase a vehicle have been assigned to QI.

Under Taxpayer's leasing program, a lessee and a dealer complete a leasing application in which the lessee applies for a credit check. Next, the dealer notifies Taxpayer of the potential lease customer and the credit check. If the credit application is approved, Taxpayer begins to process the paperwork to acquire the vehicle, which includes notifying the QI of the purchase of the vehicle.

After the necessary paperwork has been completed by all parties to the transaction, the dealer will obtain payment for the vehicle by drawing on the disbursement account controlled by QI. Once a dealer has drafted on the disbursement account, the funds will be transferred directly from the disbursement account to the dealer's account. Title will be transferred to and in the name of Taxpayer.

Within 45 days of relinquishing a vehicle, Taxpayer matches the relinquished vehicle with one replacement vehicle.

REQUESTED RULINGS

1. Each transfer by Taxpayer of a relinquished vehicle and receipt of an identified replacement vehicle in accordance with the Exchange Agreement will constitute a separate and distinct like-kind exchange transaction that qualifies for deferral of gain recognition for federal income tax purposes pursuant to section 1031.

2. Taxpayer will not be in constructive receipt of any money or other property held by QI pursuant to section 1.1031-1(k)-1(f)(1) unless and until such items are actually payable to or received by Taxpayer, on the condition that the requirements of the Exchange Agreement, representations in this ruling request, and other conditions of the safe-harbor test are in fact met.

PLR-116604-99

3. If a lessee elects to have the security deposit held by Taxpayer applied to the purchase of a vehicle, Taxpayer will not be in constructive receipt of the security deposit funds pursuant to section 1.1031(k)-1(f)(1).

4. The exchange pursuant to the Exchange Agreement of each relinquished vehicle for a properly identified and received replacement vehicle will constitute a nontaxable exchange to the extent no cash or other non-like-kind property as defined in section 1031(b) is received in the exchange. If cash or other non-like-kind property is received in the exchange, any gain with respect to the relinquished vehicles will be recognized only to the extent of such cash or other property.

5. The role of QI in the purchase of vehicles that are not replacement property, and thus not involved in the like-kind exchange constitutes routine financial or trust services for Taxpayer under section 1.1031(k)-1(k)(2)(ii) and does not disqualify QI from being a qualified intermediary under section 1.1031(k)-1(g)(4)(iii).

LAW AND ANALYSIS

Section 1031(a)(1) of the Code provides that in general, no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment.

Section 1031(b) provides that if an exchange would be within the provisions of section 1031(a) if it were not for the fact that the property received in the exchange consists not only of property permitted by such section to be received without recognition of gain, but also of other property or money, then the gain, if any, to the recipient shall be recognized, but in an amount not in excess of the sum of such money and the fair market value of such other property.

Section 1.1031(k)-1(a) of the regulations provides that a deferred exchange is defined as an exchange in which, pursuant to an agreement, the taxpayer transfers property held for productive use in a trade or business or for investment (the "relinquished property") and subsequently receives property to be held either for productive use in a trade or business or for investment (the "replacement property"). In order to constitute a deferred exchange, the transaction must be an exchange (i.e., a transfer of property for property, as distinguished from a transfer of property for money). For example, a sale of property followed by a purchase of property of a like kind does not qualify for nonrecognition of gain or loss under section 1031 regardless of whether the identification and receipt requirements of section 1031(a)(3) and paragraphs (b), (c), and (d) of section 1.1031(k)-1 are satisfied.

PLR-116604-99

The relevant qualified use of the property owned by Taxpayer and subsequently being exchanged in the transaction is the leasing of such property to third parties. Thus, the relinquished property that Taxpayer previously leased to third parties and the replacement property that Taxpayer will be leasing to third parties upon acquisition is considered property held for productive use in a trade or business in Taxpayer's hands.

Section 1.1031(a)-1(a) provides that as used in section 1031(a), the words "like kind" have reference to the nature or character of the property and not to its grade or quality. One kind or class of property may not, under that Code section, be exchanged for property of a different kind or class. As examples, section 1.1031(a)-1(c) provides that "a truck for a new truck or a passenger automobile for a new passenger automobile to be used for a like purpose" are like kind.

Section 1.1031(a)-2(b) further provides that depreciable tangible properties are of like class if they are either within the same General Asset Class, as defined in section 1.1031(a)-2(b)(2), or within the same Product Class, as defined in section 1.1031(a)-2(b)(3). Taxpayer states that the vehicles exchanged are not within these General Asset Class or Product Class safe harbors.

The General Asset Class and Product Class safe harbors in the regulations simplify the determination of whether depreciable tangible personal property is of a like kind, but they are not the exclusive method for making this determination. For depreciable tangible personal property to be considered of like kind, the property can be either like kind or like class. Section 1.1031(a)-2(a) of the regulations provides that "an exchange of properties of a like kind may qualify under section 1031 regardless of whether the properties are also of like class. In determining whether exchanged properties are of a like kind, no inference is to be drawn from the fact that the properties are not of a like class." Thus, two properties can be in different General Asset Classes (and thus not be of a like class) and yet be of like kind.

The like-kind standard has been interpreted more narrowly in the case of exchanges of personal property as compared to exchanges of real property. See California Federal Life Insurance Co. v. Commissioner, 680 F.2d 85, 87 (9th Cir. 1982). Even within the more restrictive parameters of the like-kind standard as applied to personal property, the differences between an automobile and a passenger van or an SUV do not rise to the level of a difference in nature or character but are merely a difference in grade or quality. However, a truck is different in nature or character than an automobile.

Section 1031(a)(3) states that any property received by the taxpayer shall be treated as property that is not like-kind property if (a) such property is not identified as property to be received in the exchange on or before the day that is 45 days after the

PLR-116604-99

date on which the taxpayer transfers the property relinquished in the exchange, or (b) such property is received after the earlier of (i) the day that is 180 days after the date on which the taxpayer transfers the property relinquished in the exchange or (ii) the due date (determined with regard to extension) for transferor's return of the tax imposed by this chapter for the taxable year in which the transfer of the relinquished property occurs. Section 1.1031(k)-1(c) provides that any replacement property that is received by the taxpayer before the end of the identification period will in all events be treated as identified before the end of the identification period.

In all cases, Taxpayer acquires the replacement property within the time period mandated by section 1031(a)(3).

Section 1.1031(k)-1(f)(1) provides that a transfer of relinquished property in a deferred exchange is not within the provisions of section 1031(a) if, as part of the consideration, the taxpayer receives money or other property. In addition, in the case of a transfer of relinquished property in a deferred exchange, gain or loss may be recognized if the taxpayer actually or constructively receives money or other property before the taxpayer actually receives like-kind replacement property. Section 1.1031(k)-1(f)(1) further provides that if the taxpayer actually or constructively receives money or other property in the full amount of the consideration for the relinquished property before the taxpayer actually receives like-kind replacement property, the transaction will constitute a sale and not a deferred exchange, even though the taxpayer may ultimately receive like-kind replacement property.

Section 1.1031(k)-1(f)(2) provides that except as provided in paragraph (g) of this section (relating to safe harbors), the determination of whether (or the extent to which) the taxpayer is in actual or constructive receipt of money or other property before the taxpayer actually receives like-kind replacement property is made under the general rules concerning actual and constructive receipt and without regard to the taxpayer's method of accounting. Section 1.1031(k)-1(f)(2) further explains that the taxpayer is in actual receipt of the money at the time the taxpayer actually receives the money or receives the economic benefit of the money. The taxpayer is in constructive receipt of money or property at the time the money or other property is credited to the taxpayer's account, set apart for the taxpayer, or otherwise made available so that the taxpayer may draw upon it at any time or so that the taxpayer can draw upon it if notice of intention to draw is given.

Section 1.1031(k)-1(g)(1) provides that there are four safe harbors, the use of which will result in a determination that the taxpayer is not in actual or constructive receipt of money for purposes of section 1031.

PLR-116604-99

Section 1.1031(k)-1(g)(4) provides that in the case of a taxpayer's transfer of relinquished property involving a qualified intermediary, the qualified intermediary is not considered the agent of the taxpayer for purposes of section 1031(a). In such a case, the taxpayer's transfer of relinquished property and subsequent receipt of like-kind replacement property is treated as an exchange, and the determination of whether taxpayer is in actual or constructive receipt of money before the taxpayer actually receives like-kind replacement property is made as if the qualified intermediary is not the agent of the taxpayer.

However, section 1.1031(k)-1(g)(4) only applies if the agreement between the taxpayer and the qualified intermediary expressly limits the taxpayer's rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property held by the qualified intermediary, as provided in paragraph (g)(6) of this section.

Section 1.1031(k)-1(g)(4) further provides that a qualified intermediary is a person who is not the taxpayer or a disqualified person (as defined in paragraph (k) of this section), and enters into a written agreement with the taxpayer (the "exchange agreement") and acquires the relinquished property from the taxpayer, transfers the relinquished property, acquires the replacement property, and transfers the replacement property to the taxpayer.

Section 1.1031(k)-1(g)(6) provides that an agreement limits a taxpayer's rights as provided in the paragraph (g)(6) only if the agreement provides that the taxpayer has no rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property before the end of the exchange period.

Section 1.1031(k)-1(k)(1) provides that for purposes of this section, a disqualified person is a person described in paragraph (k)(2), (k)(3), or (k)(4) of this section.

Section 1.1031(k)-1(k)(2) provides that a person is a disqualified person if the person is the agent of the taxpayer at the time of the transaction. For this purpose, a person who has acted as the taxpayer's employee, attorney, accountant, investment banker or broker, or real estate agent or broker within the 2-year period ending on the date of the transfer of the first of the relinquished properties is treated as an agent of the taxpayer at the time of the transaction. Solely for purposes of this paragraph, performance of the following services will not be taken into account –

- (i) Services for the taxpayer with respect to exchanges of property intended to qualify for nonrecognition of gain or loss under § 1031; and

PLR-116604-99

(ii) Routine financial, title insurance, escrow, or trust services for the taxpayer by a financial institution, title insurance company, or escrow company.

QI is a corporation owned by an independent third party. QI has not previously performed services other than routine financial services for Taxpayer. As such, QI is not a "disqualified person" under the regulations.

Taxpayer has assigned to QI its rights to sell the relinquished property. In all instances, the purchaser receives written notice of the assignment prior to the time that the relinquished property is transferred to the purchaser. Title to the property will be transferred from Taxpayer to the purchaser of the property pursuant to the agreement between Taxpayer and purchaser. Thus, QI will be treated as acquiring and transferring the relinquished property.

In addition, Taxpayer assigned its right to purchase replacement property to QI. In all instances, the seller receives written notice prior to the time that the replacement property is transferred to Taxpayer. Title to the property is transferred to Taxpayer. Thus, QI will be treated as acquiring and transferring the replacement property.

The Exchange Agreement provides that Taxpayer will have no rights to receive, pledge, borrow, or otherwise obtain the benefits of money or other property as required by the regulations. Proceeds from the sale of relinquished property are deposited into the escrow account. To the extent that funds from the sale of the relinquished property are insufficient to cover the purchase of replacement property, Taxpayer deposits funds to cover the amount of the purchases. Taxpayer is, therefore, not in constructive receipt of money held by QI.

Taxpayer is not in actual or constructive receipt of checks written by purchasers of relinquished property or funds held as security deposits. All agreements governing the flow of funds limit Taxpayer's ability to actually or constructively receive those funds.

CONCLUSION

Accordingly, based on your representations and the above analysis, we rule as follows:

1. Each transfer by Taxpayer of a relinquished vehicle and receipt of an identified replacement vehicle in accordance with the Exchange Agreement will constitute a separate and distinct like-kind exchange transaction that qualifies for deferral of gain recognition for federal income tax purposes pursuant to section 1031.

2. Taxpayer will not be in constructive receipt of any money or other property held by QI pursuant to section 1.1031-1(k)-1(f)(1) unless and until such items are actually payable to or received by Taxpayer, on the condition that the requirements of

PLR-116604-99

the Exchange Agreement, representations in this ruling request, and other conditions of the safe-harbor test are in fact met.

3. If a lessee elects to have the security deposit held by Taxpayer applied to the purchase of a vehicle, Taxpayer will not be in constructive receipt of the security deposit funds pursuant to section 1.1031(k)-1(f)(1).

4. The exchange pursuant to the Exchange Agreement of each relinquished vehicle for a properly identified and received replacement vehicle will constitute a nontaxable exchange to the extent no cash or other non-like-kind property as defined in section 1031(b) is received in the exchange. If cash or other non-like-kind property is received in the exchange, any gain with respect to the relinquished vehicles will be recognized only to the extent of such cash or other property.

5. The role of QI in the purchase of vehicles that are not replacement property, and thus not involved in the like-kind exchange constitutes routine financial or trust services for Taxpayer under section 1.1031(k)-1(k)(2)(ii) and does not disqualify QI from being a qualified intermediary under section 1.1031(k)-1(g)(4)(iii).

CAVEATS

A copy of this letter must be attached to any income tax return to which it is relevant. We enclose a copy of the letter for this purpose. Also enclosed is a copy of the letter ruling showing the deletions proposed to be made in the letter when it is disclosed under § 6110 of the Internal Revenue Code.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any item discussed or referenced in this letter. This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,
Robert M. Casey
Senior Technician Reviewer
Office of Associate Chief Counsel
(Income Tax & Accounting)

Enclosures (2)

cc: